Legacy

Annual Report 1986

Legacy Petroleum Ltd.

CORPORATE DATA:

Date Incorporated:
October 14, 1970

Incorporated In:
Province of Alberta

Date Continued:
February 11, 1983

Predecessor Companies:
Francis Creek Mines Ltd. (NPL)
October 14, 1970-June 14, 1971

Frances Creek Mines Ltd. (NPL)
June 14, 1971-September 9, 1975

Cal-West Petroleums Ltd. (NPL)
September 9, 1975-May 24, 1985

Head Office:
Suite 530 First Alberta Place
777 - 8 Avenue S.W.
Calgary, Alberta, Canada
T2P 3R5
(403) 264-4254

Wholly-owned Subsidiaries:
Legacy Oil & Gas Ltd.
Legacy Oil & Gas Inc.
Benchlands Oil & Gas Inc.
Harkor Developments Ltd.

Directors:
Murray F. Craig
Dr. Curt Puringer*
William Y. Kennedy
Carol A. Mossfeldt
A. Kenneth Mossfeldt
Bill Hanson*

*Appointed April 1986

Officers:
A. Kenneth Mossfeldt
President

Carol A. Mossfeldt
Vice-President, Administration

Dale H. Simpson
Vice-President, Production

Transfer Agent and Registrar:
The Canada Trust Company
505 - 3 Street S.W.
Calgary, Alberta T2P 3Y8

Auditor:
M. Jane McKinnon
C.A., B. Comm
Calgary, Alberta

Canadian Solicitors:
MacLachlan Polsky
Calgary, Alberta

Hogan & Webber
Vancouver, British Columbia

U.S. Solicitors:
James R. Learned
Attorney at Law
Cheyenne, Wyoming

Robert C. Balsam
Attorney at Law
Billings, Montana

Main Banking Connection:
Royal Bank of Canada
Calgary, Alberta

Other Banking Connections:
Heritage Savings & Trust
Company, Calgary, Alberta

First State Bank of Shelby,
Shelby, Montana

Montana Bank of Billings,
Billings, Montana

Stock Exchange Affiliation:
Alberta Stock Exchange,
Calgary, Alberta

Year End:
May 31

Trading Symbol:
LCY-A

Share Type/Capitalization/ Issued and Outstanding:
Class "A" Voting Common
Shares unlimited
2,182,898

Class "B" Non-Voting Common
Shares unlimited
nil

Preferred Shares
500,000
25 Series #1 $10,000 per share

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PRECISE DRAFTING

CAMERA READY CONTENTS BY:
DAVID B. MACLACHLAN

PRESIDENT'S MESSAGE

I read some place that a bumpy road leads to greater heights. If this is somewhat similar to the hills and valleys the oil industry is suffering at the moment then get ready for an unprecedented resur gence. Moreover, should this bumpy road reflect at all Legacy's past few years then we are happy to report that we are partially on our way. We cautiously say "partially" because we still have a lot more bumps to go. We comfort our investors by notifying them that we have an excellent nucleus of producing assets when commingled with our new staff members, I predict we will make Legacy a company with the charisma to survive during these trying times.

It is doubtful that the oil industry will ever return to the level it experienced in 1980 thanks to the National Energy Policy, the Organization of Petroleum Exporting Countries, more commonly referred to as OPEC, and deregulation. But rest assured the true "oilman" is a resilient individual and the strong will survive!!

The pressure the oil companies are feeling from the unstable price on oil and gas has seriously curtailed exploration. It is frightening to contemplate how many more junior oil companies will go under because of their bank debt. More alarming until the OPEC countries stabilize the price of crude to around $20.00 to $25.00 U.S. per barrel the industry will continue on a roller coaster ride.

Closer to home, immediate changes and assistance will be required. Fortunately for us the Petroleum and Gas Revenue Tax no longer affects the smaller producer but why wait to lift PGRT in 1988, let's lift it now. Not prolong the agony. A government program instigated towards revenue and not profit is totally wrong. The oil industry cries for help now. Let's not wait, let's pass it on to Quebec and Ontario hydro. Let's be fair. Furthermore, I humbly believe that the Alberta Government should put its shoulder behind the wheel and reduce its royalties to further assist the engine of growth. Unfortunately, before this occurs the Feds will have to lead. Despite all these reductions, bankruptcies will continue to threaten our industry until we are given the one main ingredient to survive---TIME!!

Fittingly some companies will never make it regardless of time. In most cases the inevitable is prolonged because of personal guarantees signed by officers of the company. In this regard the banks have to become less mercenary and relieve the stress on these unfortunate folks and revise their guarantees.

Further restructuring over the next few years will also be attributable to the manner in which the oil industry reacts to several major changes, namely:

1. The increase in world supply should the demise of the OPEC cartel occur;

2. The decision of the Saudis to flood the world market to maintain revenues and increase their market share;

3. The discovery of large new reserves outside of OPEC.

The oversupply is further aggravated by the decline in demand caused by slow economic growth and conservation.

The result is obvious--the law of supply and demand--more oil looking for buyers than buyers looking for oil.

These will be major factors resulting in the downturn which as a result will hit the juniors

with tenuous debt the hardest. This will cause more prevalent changes in the acquisition and merger departments.

I can't recall at any time in my 29 years in the oil industry when we have been challenged by so many adverse changes all at one time.

No one has been spared. Majors are cutting back, laying off. Even banks are learning to become creative. The margin for error is so narrow that the banks will eventually be forced to call the least suspect of loans. Wells that were economical are now shut-in.

which may not be all that far off.

Despite all these negatives and uncertainties your company is poised for an increase in its growth not anticipated before. If we can continue our success augmented further by the Alberta Government's Exploration Drilling Assistance Program, Development Drilling Assistance Program, and Well Servicing Assistance Program, your Company's exploration and land budget will exceed one million dollars by the next annual report.

Nevertheless, I predict that despite all the gloom and doom all this will eventually balance out and more opportunities will present themselves than ever before. The key is projection, commingled with tenacity and creative thinking. It will be your management's main objective, depending on finances, to watch for cheap reserves and insolvent companies in which the banks will tighten the screws.

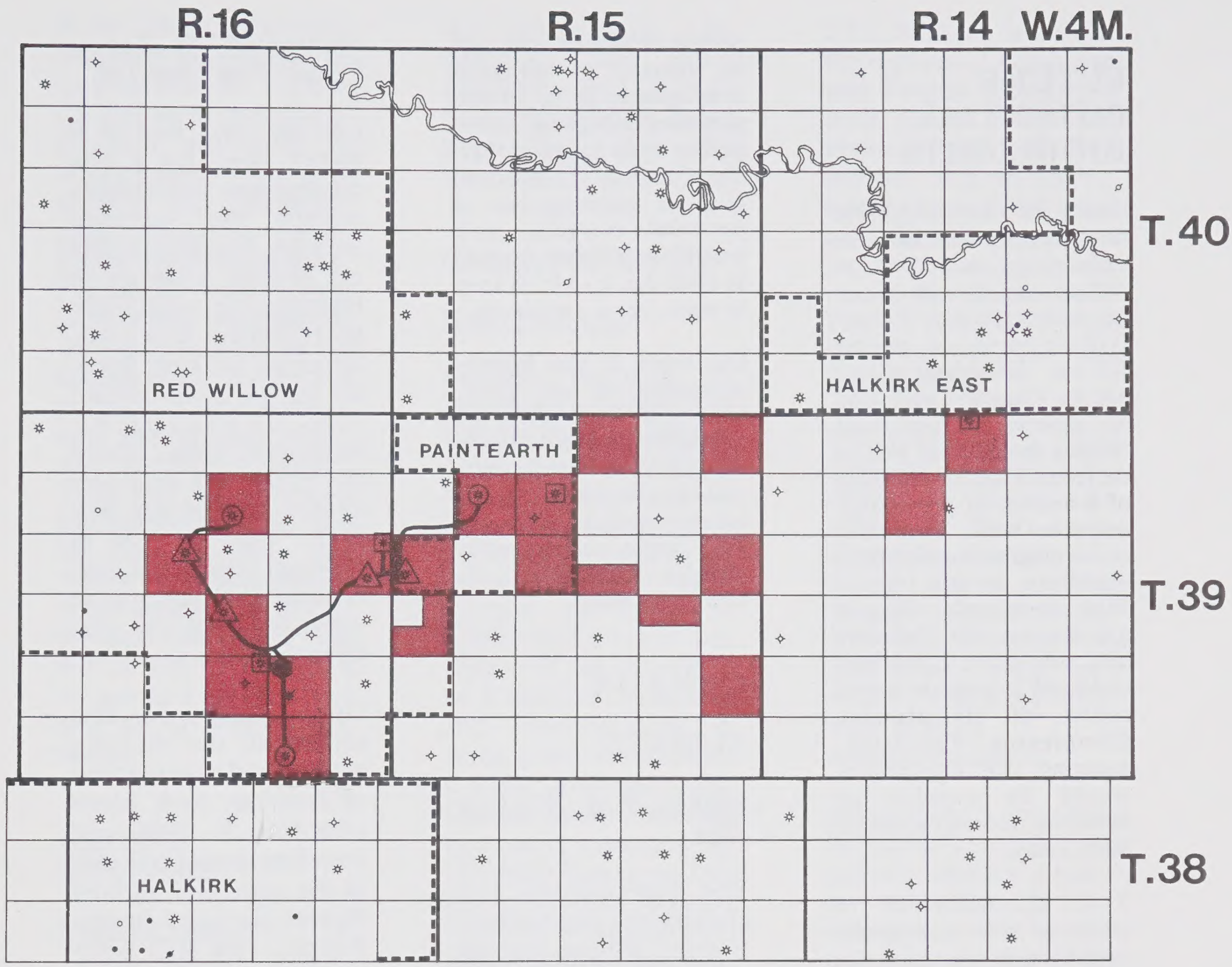
If the oil industry retrenches and most of us survive the tougher times ahead the resilience we will have displayed will result in investors' confidence returning to the energy sector in unprecedented numbers

A. Kenneth Mossfeldt,
PRESIDENT

PRICE RANGE AND TRADING VOLUME

Alberta Stock Exchange Designation:
Legacy Petroleum Ltd. - LCY-A

1985 Month	Monthly High (in Cents)	Monthly Low (in Cents)	Monthly Volume
June			360
July			20
August	35	35	1,000
October	20	15	2,500
November	25	20	7,100
December	30	21	6,920
1986			
January	25	23	11,900
February	23	18	24,900
March	17	14	13,020
April	16	15.5	11,800
May	15	12	18,480
June	16	15	24,390
July	50	15	55,600
August	85	30	162,811



LEGEND

- WELLS ON PRODUCTION AS OF MAY 31, 1986
- RE-ENTRY PROGRAM
- PROPOSED DRILLING PROGRAM
- LEGACY INTEREST LEASES
- LEGACY OPERATED GAS PLANT
- GAS GATHERING FACILITIES

LEGACY PETROLEUM LTD.

RED WILLOW AREA

ALBERTA

AS OF MAY 31, 1986

FUTURE POTENTIAL HIGHLIGHTS

During the balance of 1986, the Company will focus on obtaining maximum deliverability from its oil and gas reserves in Red Willow-Halkirk area of central Alberta. Subsequent to year end the Company undertook an aggressive four well drilling program, as well as the re-entry and recompletion of a number of previously suspended wells. The results of this program are referred to elsewhere in this report. With substantially increased gas reserves, the Company also, subsequent to year end, undertook a complete turn-around of its Halkirk Compressor facilities, ensuring that equipment would be capable of delivering volumes up to 3.5 MMCF/day.

Your management is interested in increasing and expanding its interest in the Halkirk-Red Willow Area, and in this regard is currently negotiating the acquisition of the interests of several of its partners. As well, your Company has entered into negotiations with major interest owners of additional lands and facilities in the area, with a view to possible acquisition.

As noted in previous reports to shareholders, it is the intention of the Company to seek growth from its cash flow. While year end results continue to show a loss, the recent drilling and recompletion activity at Halkirk should bring a significant increase to revenues prior to year end. A portion of this revenue will be utilized to enhance development of its current properties through anticipated drilling in the spring of 1987. The Company will continue with its investigation of potential mergers, and possible acquisitions, keeping in mind that it seeks to keep its bank debt at a minimum.

Our future is also largely dependent on our staff. Legacy is proud that it has increased its staff from two to six full time employees, since year end. We strongly believe that these individuals will make substantial contributions to the Company's future.

CANADA

ALBERTA

Halkirk-Red Willow Area

The purchase of the Halkirk gas plant east of Stettler, Alberta and the subsequent re-entering of previously suspended wells combined with drilling four successful wells within the prospect have made this year the most exciting for your Company in its transition from a broker of oil and gas leases to an explorer, producer and marketer of hydrocarbons.

Subsequent to year end, we expect to be producing over 200 barrels of oil per day and have the "lions" share of 2.5 MMCF/Day of natural gas which is contracted to Trans Canada Pipe Lines Ltd.

Let me say, that if it hadn't been for a few courageous individuals within the service industry who believed in our drilling program at Halkirk, we would not be reporting how very fortunate we have been. So far we have drilled four consecutive successful wells. Three are Viking gas with over fifteen feet of net pay each. One resulted in two gas zones and one oil zone that may prove very exciting for the Company.

Unfortunately for this report, all our drilling activity and development of reserves took place after May 31, 1986, and therefore are not reflected in the year end audited figures included in this Report. We also point out that our Halkirk Plant facilities were shut down for the months of July and August 1986 while we undertook some major repairs to equipment to ensure that it would be capable of delivering our contract volume as of November 1, 1986. The plant went back on stream September 2, 1986 at a nomination of one-fifth of total contract amount, and as a result, the effect of the recent drilling and re-entry work will not be experienced in the financial statements until later in the fiscal year.

It is management's intention to continue its exploration and development program at Halkirk in order to develop ready reserves to supply our contract requirement to Trans Canada at 2.5 mmcf/day. Fittingly we are negotiating purchase of shut-in properties in the surrounding area for the purpose of developing a spot gas market which will increase our revenue from our investment substantially. This will be done within our means with the caveat to never go into debt unless the debt can be paid off within two years based on gas at $1.00 per mcf and oil at $10.00 per barrel.

BRITISH COLUMBIA

Granite Creek

For once we have some good news to dispatch on our gold and platinum mine located northwest of Princeton, British Columbia. We are negotiating a farmout in which the farmee has agreed to spend a minimum of $250,000 on exploration and development prior to December 31, 1988. As well the farmee has an option to purchase your Company's interest for $500,000, said option to be exercised on or before December 31, 1987.

An agreement in principal has been reached, and final documentation is being processed by the solicitors.

SASKATCHEWAN

North Steelman

Further drilling at Steelman has been put on hold for the moment with only one possible location remaining to be drilled. The last report indicated a Frobisher oil discovery on lands farmed to Lasmo Exploration Canada Ltd. This well has proven to be a marginal producer and consideration is being given to making it a water disposal well. On the other hand the two wells operated by Macedon Resources Ltd. are producing nicely, with one having reached payout prior to year end. Unfortunately with the down turn in oil prices there isn't the incentive to produce the wells to their capacity.

UNITED STATES

It has been terribly frustrating to see the fruits of our labour throughout Central Montana gradually being surrendered without the satisfaction of seeing a successful well drilled. Legacy, through its wholly-owned U.S. subsidiary held over 212,000 acres throughout Petroleum and Fergus Countries with gross overrides between one and five percent. It is not known exactly how many acres are left with overrides but an educated guess would be about half. The balance will disappear over the next few years.

The Company's last working interest lease expired in July of this year and thus only overrides remain as noted above. The struggle to maintain our interest in the Northern States was long and costly. This experience will always to be a lesson to remember.

As previously reported, the parent company was actively seeking a suitor to sell the U.S. subsidiary who could maximize the use of the tax loss in this country. However, with the downturn in the industry in general in North America, a number of firms who had expressed interest in the tax loss withdrew from negotiations until such time as the industry revives. The tax losses in this firm continue for a number of years, and your Company will continue to actively seek a buyer for the U.S. entity.

AUDITOR'S REPORT

To the Shareholders of
Legacy Petroleum Ltd.

I have examined the consolidated balance sheet of Legacy Petroleum Ltd. as at May 31, 1986 and the consolidated statements of loss, deficit and changes in financial position for the year then ended. My examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, these consolidated financial statements present fairly the financial position of the Company as at May 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The comparative figures used in these financial statements were reported on by other Chartered Accountants.

M. Jane McKinnon

August 30, 1986
Calgary, Alberta

M. Jane McKinnon
Chartered Accountant

LEGACY PETROLEUM LTD.
CONSOLIDATED BALANCE SHEET
MAY 31, 1986

ASSETS

	1986	1985
CURRENT ASSETS		
Cash	$ 1,787	$ 1,353
Accounts receivable	33,012	43,002
Oil and gas properties held for sale	3,524	14,680
Prepaid Expenses	8,033	--
Current porton of notes receivable (Note 2)	2,125	2,125
	48,481	61,160
NOTES RECEIVABLE (Note 2)	567,156	569,281
CAPITAL ASSETS (Note 3)		
Mineral properties	591,607	591,607
Petroleum and natural gas properties	311,778	83,531
Automotive	4,100	--
Other equipment	19,630	12,885
	927,115	688,023
Less: Accumlated depreciation and depletion	37,420	7,159
	889,69	680,864
	$1,505,332	$1,311,305

APPROVED BY THE BOARD:

M. Hbrag DIRECTOR

B. Massfeldt DIRECTOR

LEGACY PETROLEUM LTD.
CONSOLIDATED BALANCE SHEET
MAY 31, 1986

LIABILITIES

	1986	1985
CURRENT		
Bank indebtedness (Note 4)	$20,311	$19,368
Accounts payable and accrued liabilities	99,024	75,132
Salary payable	16,638	--
Note payable	--	4,875
Current portion of promissory note payable to officer and director (Note 6)	33,000	33,000
Due to shareholders (Note 5)	40,041	35,813
Current portion of long-term debt (Note 7)	97,469	78,255
	306,483	246,443
ADVANCE FROM LANDLORD ON LONG-TERM LEASE (Note 8)	12,375	--
BONUS PAYABLE TO OFFICER AND DIRECTOR DUE DECEMBER 31, 1995	391,000	391,000
PROMISSORY NOTES PAYABLE TO OFFICER AND DIRECTOR (Note 6)	177,784	129,457
LONG-TERM DEBT (Note 7)	--	27,600
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 9)		
Authorized -		
Unlimited Class A voting common shares		
Unlimited Class B non-voting common shares		
500,000 Preferred shares		
ISSUED -		
25 Preferred shares (1985-0)	250,000	--
2,182,898 Class A shares (1985-2,182,898) 2,915,023	--	2,915,023
	3,165,023	2,915,023
DEFICIT	(2,547,333)	(2,398,218)
	617,690	516,805
	$1,505,332	$1,311,305

LEGACY PETROLEUM LTD.
CONSOLIDATED STATEMENT OF LOSS
YEAR ENDED MAY 31, 1986

	1986	1985
REVENUE		
Sale of leases	$ --	$ 246,973
Oil sales	9,986	--
Gas sales	141,884	--
Other	24,665	28,167
	$ 176,535	$ 275,140
Less: Royalties	$ 19,949	$ --
	$ 156,586	$ 275,140
EXPENSES		
Cost of leases sold	$ --	$ 468,256
Operating	45,754	--
Interest on long-term debt	16,711	8,294
General and administrative	163,926	299,334
Commissions (recovered)	(21,573)	27,255
Depreciation and depletion	$ 31,331	$ 1,400
	$ 236,149	$ 804,539
LOSS FROM OPERATIONS	$ (79,563)	$ (529,399)
Oil and gas properties surrendered	$ 65,084	$ 256,854
Mining property surrendered	$ --	$ 175,000
LOSS BEFORE INCOME TAXES AND EXTRAORDINARY ITEMS	$ (144,647)	$ (961,253)
Income taxes	$ 1,428	$ 208,416
LOSS BEFORE EXTRAORDINARY ITEMS	$ (146,075)	$(1,169,669)
EXTRAORDINARY ITEMS		
Gain on settlement of debt net of applicable income taxes of $82,140	$ --	$ 726,131
Write off of amounts due to previous shareholders	--	48,325
Recovery of income taxes due to application of prior year losses	$ 6,960	$ 291,840
	$ 6,960	$ 1,066,296
NET LOSS FOR THE YEAR	$ (139,115)	$ (103,373)
DEFICIT, Beginning of year	$ (2,398,218)	$(2,294,845)
	$ (2,537,333)	$(2,398,218)
Dividends	$ (10,000)	$ --
DEFICIT, End of year	$ (2,547,333)	$(2,398,218)
BASIC EARNINGS (LOSS) PER COMMON SHARE (Note 9)		
Before extraordinary items	$ (0.08)	$ (0.58)
Extraordinary items	$ 0.01	$ 0.53
	$ (0.07)	$ (0.05)

LEGACY PETROLEUM LTD.
CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED MAY 31, 1986

	1986	1985
Operations:		
Net loss	$ (139,115)	$ (103,373)
Add		
Depreciation and depletion	31,331	1,400
Capital assets surrendered		
- petroleum and natural gas properties	35,327	176,409
- mining properties	--	175,000
Write-off of other assets	--	1,156
Non cash payment of salary	48,327	129,457
Less: Gain on sale of capital assets	$ (1,482)	$ --
	$ (25,612)	$ 380,049
Financing:		
Preferred shares issued for petroleum and natural gas properties	$ 250,000	$ --
Common shares issued in settlement of debt	--	202,597
Lease rental inducement	12,375	--
Proceeds on sale of capital assets	2,750	--
Proceeds on note receivable	2,125	2,125
Proceeds on long-term debt	$ 16,786	$ 85,966
	$ 258,424	$ 670,737
Repayment of long-term debt	(44,386)	(58,366)
Dividend on preferred shares	$ (10,000)	$ --
	$ 204,038	$ 612,371
Change in working capital other than cost	$ 73,153	$ (584,156)
	$ 277,191	$ 28,215
Investing:		
Additions to capital assets		
Petroleum and natural gas properties	$ 263,573	$ (14,240)
Automotive and other equipment	$ (13,184)	$ --
	$ (276,757)	$ (14,240)
Increase in cash	$ 434	$ 13,975
Cash (bank overdraft) beginning of year	$ 1,353	$ (12,622)
Cash, end of year	$ 1,787	$ 1,353

LEGACY PETROLEUM LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MAY 31, 1986

1. SUMMARY OF ACCOUNTING POLICIES:

The following accounting principles and practices are set forth to facilitate the understanding of data presented in the financial statements:

(a) Principles of Consolidation

The activities of the Company and its wholly-owned subsidiaries, Harkor Developments Ltd., and Legacy Oil and Gas Ltd. and its wholly-owned United States subsidiaries, Legacy Oil and Gas Inc. and Benchlands Oil and Gas Inc. are enclosed in these financial statements.

The acquisitions of the subsidiary companies have been accounted for by the purchase method, and accordingly, earnings or losses since the dates of acquisition are included in the consolidated statement of loss and deficit.

The excess of consideration paid for the shares of the subsidiary companies over the book value of their net assets at dates of acquisition has been included in mineral properties and oil and gas properties held for resale in the consolidated financial statements and has been amortized or written off on the same basis as such assets.

(b) Capital Assets

(i) Mineral Properties

Acquisition and deferred exploration and development cost are capitalized on an area of interest basis. These expenditures will be charged against income when properties are developed to the stage of commercial production through unit of production depletion. Accumulated costs related to an area of interest are charged to earnings if the property is sold or abandoned.

The amounts shown for mineral properties represent cost to date and do not necessarily reflect present or future values.

Development of mineral properties and recovery of related costs are dependent upon capital financing arrangements, mineral market conditions, environment considerations and general economic conditions.

(ii) Petroleum and Natural Gas Properties

The Company follows the full cost method of accounting for oil and gas operations whereby all costs related to exploration for and development of oil and gas reserves are capitalized. Costs capitalized include those related to acquisition of petroleum and natural gas rights, geological and geophysical expenses, carrying costs on non-producing property, drilling of wells and applicable overhead expenses. These capitalized costs are accumulated in separate geographically located cost centres for each country in which the Company operates, at present Canada and the United States. All such costs are depleted on the unit of production method based on estimated proven reserves of oil and gas.

The Company carries its oil and gas properties at the lower of costs and the estimated present value of future net revenues from production of the underlyig reserves.

Substantially all of the Company's exploration, development and production activities related to oil and gas are conducted jointly with others; accordingly, the accounts reflect only the Company's proportionate interest in such activities.

(iii) Other

Automotive and other equipment are depreciated using the declining balance method at the following rates per annum:

Automotive	30%
Other Equipment	20%

(c) Foreign Currency Translation

The foreign subsidiaries accounts have been translated into Canadian dollars at the rate in effect at the balance sheet date for monetary assets and liabilities. Non monetary assets and liabilities are translated at applicable historical rates. Revenue and expense items are translated at the average rate of exchange for the year.

(d) Operations

During the fiscal year ended May 31, 1986 the Company changed its major focus of operation from the acquisition of petroleum and natural gas leases for resale to the development and marketing of petroleum and natural gas resources.

(e) Comparative figures

Certain of the comparative figures have been reclassified to conform with the financial statement presentation adopted in the current year.

2. NOTES RECEIVABLE

	1986	1985
Notes receivable due December 31, 1995	$391,000	$391,000
Notes receivable due October 1990, repayable in annual installments of $1,525 to May 31, 1990 with the balance of $143,381 due; $116,811 July 1, 1990 and $26,570 October, 1990	149,481	151,006
Notes receivable due December 1995, repayable in annual installments of $600 to May 31, 1994 with the balance of $23,700 due; $12,000 June, 1994 and $11,700 December, 1995	28,800	29,400
	569,281	571,406
Current portion	2,125	2,125
	$567,156	$569,281

The notes receivable are non-interest bearing and are due from present and former officers and directors of the Company.

3. CAPITAL ASSETS

	1986			1985
	Cost	Accumulated Depletion and Depreciation	Net Book Value	Net Book Value
Canadian petroleum and natural gas properties	$311,778	$28,758	$283,020	$ 83,531
Canadian mineral properties	591,607	--	591,607	591,607
Automotive	4,100	405	3,695	--
Other	19,630	8,257	11,373	5,726
	$927,115	$37,420	$889,695	$680,864

The mineral properties consist of a 100% interest in four placer leases at Granite Creek, British Columbia. The Company had previously entered into a farmout agreement whereby the farmee, Kensington Holdings Ltd., could earn an 80% working interest in the Granite Creek prospect. This agreement has been terminated by the Company and in the opinion of the Company's legal counsel no interest was earned by the farmee. The Company has therefore entered into preliminary negotiations to farmout the Granite Creek prospect and retain a net 20% carried interest.

4. BANK INDEBTEDNESS

	1986	1985
Bank loans	$20,311	$19,368

The bank loans bear interest at the prime rate plus 2% and are secured by the following:

(a) general assignment of book debts;
(b) assignment of specific production income;
(c) assets of the President of the Company.

5. DUE TO SHAREHOLDERS

The amounts due to shareholders are unsecured, are either non-interest bearing or bear interest at rates ranging from 15% to 17.75 % are are due on demand.

6. PROMISSORY NOTES PAYABLE TO OFFICER AND DIRECTOR

	1986	1985
Promissory note, payable to A.K. Mossfeldt, repayable in annual installments of $8,000 on December 31, 1986 to 1988, $7,250 on December 31, 1989, and $8,000 on December 31, 1990	$ 39,250	$ 39,250
Promissory note, payable to A.K. Mossfeldt, repayable in annual installments of $25,000 on December 31, 1986 to 1988, $23,207 on December 31, 1989 and $25,000 on December 31, 1990	171,534	123,207
	210,784	162,457
Current portion	33,000	33,000
	$177,784	$129,457

7. LONG-TERM DEBT

	1986	1985
U.S. Bank loan (U.S. $8,213) at 14.5% due April 1, 1986 repayable in monthly installments of U.S. $2,000 principal and interest with the balance due December 25, 1986	$11,395	$ 23,321
U.S. Bank loan (U.S. $62,040) bearing interest at prime plus 1% due September 30, 1986, secured by assets of the President of the Company	86,074	82,534
	97,469	105,855
Current portion	97,469	78,255
	$ --	$ 27,600

8. ADVANCES FROM LANDLORD ON LONG-TERM LEASE

During the year the Company received $15,000 as a rental incentive for leasing new office premises. This payment has been deferred and taken into income on a straight line basis over the 5-year term of the lease.

9. CAPITAL STOCK

Issued:

(a) Class A Voting Shares

	1986		1985	
	Number of Shares	Stated Value	Number of Shares	Stated Value
Balance, beginning of year	2,182,898	$2,915,023	8,875,382	$2,712,426
Issue of shares in settlement of accounts payable	--	--	321,710	30,857
Issue of shares in settlement of bank loan	--	--	884,448	88,445
Issue of shares in settlement of note payable to director	--	--	712,948	71,295
Issue of shares for service rendered by former director	--	--	120,000	12,000
	2,182,898	$2,915,023	10,914,488	$2,915,023
Conversion adjustment pursuant to shareholders' resolution	--	--	(8,731,590)	--
	2,182,898	$2,915,023	2,182,898	$2,915,023

(b) First Preferred Shares

	1986		1985	
	Number of Shares	Stated Value	Number of Shares	Stated Value
Balance, beginning of year	--	--	--	--
Issued	25	250,000	--	--
	25	$250,000	--	--

During the year, the Company issued, 25 First Preferred shares par value $10,000 for 50% direct interest in certain oil and gas properties, a gas plant and facilities and related gas contracts.

Pursuant to a Directors resolution dated September 23, 1985, the rights of these shares have been designated as follows:

(a) 8% cumulative, redeemable restractable convertible

(b) the shares are retractable as follows:

8 shares on May 1, 1987
8 shares on November 1, 1987
9 shares on November 1, 1988

(c) in the event the Corporation defaults on any divided payment or share retraction the holder of the shares may convert the shares to common trading shares or reclaim that percentage of the plant and properties not paid for. The conversion to common trading shares will be based upon the number of preferred shares outstanding plus accumulated dividends, divided by the common share value prior to conversion.

(d) Earnings Per Share

Basic net income per common share is calculated using the weighted average number of common shares outstanding during the year.

Fully diluted earnings per share for the year ended May 31, 1986 would be:

Loss before extraordinary item	$(0.06)
Including extraordinary item	$(0.05)

10. RELATED PARTY TRANSACTIONS

During the year, the Company was charged $29,300 (1985 - $35,500) for consulting services by a related company, Igneous Industries Ltd.

11. INCOME TAXES

The Company has accumulated losses for Canadian income tax purposes of $451,987 and $657,884 (U.S.) for United States income tax purposes, the related benefit of which has not been recognized in the financial statements. Unless sufficient taxable income is earned by the Company, the losses for Canadian income tax purposes expire as follows:

1987	$ 16,538
1990	46,909
1991	381,139
1992	10,401

The losses for United States income tax purposes will expire in 2000.

12. SUBSEQUENT EVENTS

Subsequent to May 31, 1986, 650,000 Class A voting common shares were reserved for stock options for issue at an exercise price of $0.11 per share pursuant to terms of an option agreement which expires April 30, 1996.

Subsequent to the year end, 150,000 Class A voting common shares were reserved for a private placement issue at $0.35 per share. Total proceeds of the issue is $52,500.

13. SEGMENTED INFORMATION

The Company's operations are conducted in Canada and the United States through three industry segments -- the sale of oil and gas leases, mineral exploration and oil and gas production.

Industry

	1986	1985
Revenue		
Sale of oil and gas leases		$ 246,973
Oil and Gas Production	$ 131,921	--
	$ 131,921	$ 246,973
Operating Income (Loss)		
Oil and gas leases	$ (43,511)	$ (505,392)
Mineral exploration	--	(175,000)
Oil and Gas Production	86,167	--
General corporate expenses, net of revenues	139,261	271,167
Interest on long-term debt	16,711	8,294
Depletion and depreciation	31,331	1,400
Corporate Taxes	1,428	208,416
Loss before extraordinary items	$ (146,075)	$ (1,169,669)
Identifiable Assets		
Oil and gas leases	$ 3,524	$ 141,213
Mineral exploration	591,607	591,607
Oil and gas properties	317,032	--
	912,163	732,820
	593,169	578,485
	$1,505,332	$ 1,311,305

Geographic Area

	1986	1985
Revenue		
Canada	$ 151,870	$ --
United States	--	246,973
	$ 151,870	$ 246,973
Operating Income (Loss)		
Canada	$ 86,167	$ --
United States	(43,511)	(680,392)
	$ 42,656	$ (680,392)
Identifiable Assets		
Canada	$ 908,639	$ 603,203
United States	3,524	129,617
	912,163	732,820
Corporate - Canada	593,169	578,485
	$1,505,332	$1,311,305

Corporate History:

Legacy Petroleum Ltd. was incorporated October 14, 1970 as Francis Creek Mines Ltd. (NPL), a private company. On June 14, 1971, Francis Creek Mines Ltd. (NPL) changed its name to Frances Creek Mines Ltd. (NPL), a private company. On December 21, 1971 Frances Creek Mines Ltd. (NPL) became a publicly listed corporation on the Alberta Stock Exchange. In September 1975, the Corporation changed its name to Cal-West Petroleums Ltd. (NPL). In April of 1976 the Company acquired all the issued and outstanding shares of Harkor Developments Ltd., a private company, whose primary asset was a gold mining claim at Granite Creek, British Columbia. This mining claim was subsequently partially developed and remains an asset of the Corporation at this time.

Until early 1983, the Company was primarily involved in mining related activities. In March of 1983, the Company acquired petroleum and natural gas leases in the State of Montana, providing Cal-West Petroleums Ltd. (NPL) with a more diversified portfolio.

In May 1983, A. Kenneth Mossfeldt, and business associates replaced the previous management of the Company on the Board of Directors. Mr. Mossfeldt was then President of the private Calgary based Legacy Oil & Gas Ltd., and its wholly-owned subsidiaries, Legacy Oil & Gas Inc. and Benchlands Oil & Gas Inc. In September 1983, shareholders of both Cal-West Petroleums Ltd. (NPL) and Legacy Oil & Gas Ltd approved a share exchange whereby Cal-West acquired the 3,300,009 issued and outstanding shares of Legacy Oil & Gas Ltd. (representing 100% of the total issued and outstanding shares of Legacy) for a like number of shares of Cal-West.

In mid-May of this year Shareholders ratified a change of name from Cal-West Petroleums Ltd. (NPL) to Legacy Petroleum Ltd. Also at the May 15, 1986 Special Meeting, shareholders approved a consolidation of share capital based on five (5) of the old Cal-West shares for each one (1) of the new Legacy Shares. In addition shareholders approved the creation of a Class "B" non-voting common share, and the creation of preferred shares. The creation of additional share types reflected the Company's need to achieve greater flexibility for negotiating agreements and/or purchases which would subsequently enhance the potential for growth. No Class "B" or Preferred Shares have been issued as of the date of this report.

The Cal-West designation for the company was delisted from the Alberta Stock Exchange and "Legacy Petroleum Ltd." was called for trading on June 26, 1985. The initial trade in the Legacy designation was made on August 21, 1985 at 35 cents per share.

November 1, 1986, Legacy Petroleum Ltd. issued to Merland Explorations Limited, now North Canadian Oils Limited twenty five (25) 8% Redeemable Retractable Convertible First Preferred Shares with a value of $10,000.00 per share. These shares are in payment for the acquisition of the Halkirk Gas Plant, leases, and producing wells referred to earlier in this report. Eight shares are retractable May 1, 1987, eight shares are retractable November 1, 1987 and the balance of nine shares are retractable November 1, 1988.

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